Joint Committee on Taxation
April 1, 1980
JCX-4-80

S. 2480 -- Senator Nelson

Increase in Minimum Accumulated Earnings Credit

Present law

In addition to the regular corporate income tax, present law imposes an accumulated earnings tax of 27½ percent to 38½ percent on improperly accumulated corporate earnings where the accumulation occurs in an attempt to avoid the individual income tax. In computing the base on which this tax is imposed, there is excluded an amount equal to the earnings and profits of the taxable year which are retained for the reasonable needs of the business. This is known as the accumulated earnings credit. Present law provides a minimum credit of $150,000 of earnings which may be accumulated before any accumulated earnings are subject to this tax. This is a cumulative credit rather than an annual credit. Thus, if more than $150,000 of earnings is accumulated, the accumulated earnings are subject to the "reasonable needs of the business" standard.

The minimum accumulated earnings credit was increased from $60,000 to $100,000 in 1958. It was increased from $100,000 to its present level of $150,000 in 1975.

Issue

The issue is whether the minimum accumulated earnings credit should be increased from $150,000 to $250,000.

Description of bill

The bill would increase the minimum accumulated earnings credit from $150,000 to $250,000.

Effective date

The bill would apply to taxable years beginning after December 31, 1980.

Revenue effect

The revenue loss of this bill depends on the amount of corporate earnings that would be distributed to shareholders under the present law but would be retained by corporations if this bill becomes law. Because the staff does not know how many corporations would elect to increase their retained earnings as a result of this bill and when these corporations would do it, no revenue estimate has been prepared.

However, the potential revenue effect could be substantial because for each corporation that increases its retained earnings by $100,000, the revenue loss is about $40,000.

JOINT COMMITTEE